SUMMARY of COOPERATIVE CASES

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UNITED STATES DEPARTMENT OF AGRICULTURE
FARMER COOPERATIVE SERVICE

LEGAL SERIES NO. 17 JUNE 1961

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The comments on cases reviewed herein represent the personal opinion of the author, and not necessarily the official views of the Department of Agriculture.

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(Pomeroy Cooperative Grain Co. v. Commissioner of Internal Revenue. 288 F. 2d 326 (1961))

This decision upholds, in part, the decision of the Tax Court, 31 T.C. 674, and reverses and remands that decision in part. The Tax Court had held that patronage refunds for the taxable years 1953, 1954, and 1955, were not excludable from this nonexempt cooperative's gross income where they arose out of the following types of transactions:

1. Compensation received by the cooperative from the Commodity Credit Corporation for handling and storage of grain which both members and nonmembers of the cooperative had surrendered to the C.C.C. in satisfaction of Government crop loans.

2. Compensation received from nonmembers other than the C.C.C. including producers and nonproducers, for grain storage.

3. Compensation received from members for grain storage.

(See Legal Series No. 8, "Summary of Cooperative Cases", March, 1959, p. 2.)

The Eighth Circuit Court of Appeals affirmed the decision of the Tax Court as to the nonexcludability to the cooperative of the compensation described in items numbers 1 and 2 above. As to item 3, the Circuit Court found that the Tax Court erred in disallowing the cooperative an exclusion for earnings derived from grain stored by its members and allocated to them, and remanded the case to the Tax Court for determination of the amount of the exclusion allowable for earnings arising from member grain storage business allocated in the form of patronage refunds.

The Circuit Court referred to the three prerequisites which the Tax Court stated had to be met to make the patronage dividends

excludable from the gross income of the cooperative, namely:

1. The allocation must have been made pursuant to a legal obligation which existed at the time the patron transacted his business with the cooperative.

2. The allocation must have been made out of profits or income realized from transactions with the particular patrons for whose benefit the allocations were made, and not out of profits or income realized from transactions with other persons or organizations which were not entitled to participate in such allocations.

3. The allocations must have been made equitably; so that profits realized on the one hand from selling merchandise or services to patrons, and those realized on the other hand from marketing products purchased from patrons were allocated ratably to the particular patron whose patronage created each particular type of profit.

In affirming the decision of the Tax Court with respect to items 1 and 2, the allocation of patronage refunds arising from compensation received from the Commodity Credit Corporation (hereinafter referred to as CCC) and from nonmembers other than the CCC, the Court observed that only the first two of the above-cited prerequisites were relevant, and found that the second prerequisite had not been met by the cooperative. The Court stated that under a loan agreement with CCC, the producer had the option of delivering the number of bushels of grain covered by his loan to the CCC in full satisfaction of the loan, or of paying the loan plus interest and retaining the grain. The producers elected to deliver the grain to the CCC in satisfaction of their loans or had defaulted on their loans. CCC had a uniform grain storage agreement with the cooperative under which the cooperative agreed to perform certain handling and storage services at agreed rates. The grain which had served as security for the loans was delivered to the cooperative by the producers pursuant to written instructions to the producers from the county CCC committee.

The Court asserted that title to the mortgaged grain passed to the CCC before the storage and handling fees involved were earned and that the cooperative performed these services for and at the

direction of CCC and were paid for such services by CCC. No storage contract or agreement as to the CCC grain ever came into existence between the cooperative and its producer-patrons. The Circuit Court concluded that, in view of these facts, the Tax Court was warranted in determining that these storage and handling charges collected by the cooperative from the CCC were not profit or income realized from transactions with member-patrons of the cooperative and that in allocating patronage refunds from this source of income the second prerequisite had not been met.

As to the allocations of refunds from profits arising from the storage charges earned on grain belonging to nonmembers, the Court asserted that these allocations also failed to qualify as true patronage dividends for the same reasons that the CCC storage profits failed to qualify.

As to the remaining issue pertaining to allocations of patronage refunds arising from earnings from the storage fees received for storage of grain belonging to members, the Circuit Court agreed with the Tax Court that the first two prerequisits had been met. The Tax Court had held, however, that such patronage refunds were not excludable from gross income because the third prerequisite had not been met. Storage earnings had been allocated to members upon the same basis as income from grain purchased from members, both being allocated to all members on the basis of the number of bushels delivered to the elevator either for storage, sale to the cooperative, or surrender to CCC.

The Circuit Court, in reversing the Tax Court on this issue, questioned the validity of this prerequisite to the extent that it went beyond requiring an equitable distribution of profits arising from member business to participating members. Excerpts from the Court's opinion follow:

> "The Tax Court as a basis for its determination that the distribution of profits from member-storage business did not meet its third requirement observed that not all members who sold taxpayer their grain stored their grain, that those who stored various grains did so for different periods; that a large part of the storage revenue was derived from storage of beans, while the largest part of the grain delivery consisted of corn, and that profits might vary in the storage of various types of grain. The Tax Court cited no statutes, regulations or cases to support its ruling upon this issue. It appears to us that traditionally the farmers' cooperative business has been divided into two categories,

the grain department and the merchandise department. The savings of the merchandise department are generally allocated to members upon a dollar basis and those of the grain department upon a bushel basis. See Farmers Cooperative Co. v. Birmingham, (N.D.Ia.), 86 F. Supp. 201; Glover Farm Stores Corp., 17 T.C. 1265; Rev. Rul. 59-107, supra, I.T. 3208 C.B. 1938-1, p. 127.

"In Birmingham, at p. 215, the court quotes extensively from Adcock, Patronage Dividends; Income Distribution or Price Adjustment, 13 Law and Contemporary Problems 505, 520, including the following:

> 'A general analysis of the business operations of cooperatives reveals the impracticability if not the impossibility, of relating patronage dividends to gain or loss upon any particular transaction with any particular patron.'

"It is also there pointed out that on some grain purchases the price will rise and a large profit result while in other situations a loss may be suffered because of a price decline. There appears to be no requirement that a patronage dividend a member receives be based on the profit made on his particular transaction. It appears to be sufficient if the profits arising from member business are equitably distributed among the members who have transacted business with the cooperative.

"From a revenue standpoint, the Commissioner should be more concerned with the total exclusions allowable on membership business profits rather than the means by which such profits are divided among the qualified members, As stated in the Birmingham case at p. 213, "the crucial question involved in determining the taxability of patronage dividends is whether they constitute income to the cooperative, or to the patron, or to both.

"The Tax Court committed error in disallowing taxpayer an exclusion for profits derived from grain stored by its members and allocated to its members. The case is remanded to the Tax Court for determination of the amount of the exclusion allowable for profits arising from member grain storage business, which have been allocated in the form of patronage dividends."

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TAXATION - PATRONAGE REFUNDS - NONEXEMPT COOPERATIVES

(Farmer Cooperative Company v. Commissioner of Internal Revenue, 288 F. 2d 315 (1961))

This case came before the Court upon petition by the taxpayer, a nonexempt cooperative corporation, for review of a decision of the Tax Court, 33 T.C. 266 (See "Summary of Cooperative Cases", Legal Series No. 11, p. 48, Dec. 1959).

This decision considered two important issues, one referred to as the broad issue and the other as the narrow issue. The so-called broad issue in the case was whether a cooperative could exclude from its income the amounts of noncash patronage refunds which were not taxable to the patrons. The Government contended that income is earned from the operations of a cooperative and should be taxed to someone and that, since the patronage refunds in question were not currently taxable to the patrons, they were not excludable from income by the cooperative and were taxable to it. The Eighth Circuit Court of Appeals rejected this contention by the Government as it did in a similar case, Pomeroy Cooperative Grain Co. v. Commissioner, 288 F. 2d 326.

On the narrow issue, the Court reversed the Tax Court's decision that a nonexempt cooperative could not exclude from income for tax purposes noncash patronage refunds if it did not give actual notice to each patron of the dollar amount of his share of such patronage refunds before the cooperative's tax return was due.

On its income tax return for 1953, the cooperative had claimed an exclusion from its gross income for patronage refunds in the amount of $2,415.35. The cooperative's stockholders present at its annual meeting held March 12, 1954, were notified of the total patronage refund, but the individual patrons were not notified of the dollar amounts of their separate patronage refunds until February 10, 1955. On its return for 1954, the cooperative claimed an exclusion from gross income for patronage refunds in the amount of $10,470.72. Although the stockholders attending the annual meeting February 28, 1955, were informed of the total patronage refund for 1954, the individual patrons were not notified of the amounts of their patronage refunds until October 10, 1956. The evidence in this case indicated that the patronage refunds for the years were set aside on the books of the corporation to the credit of the patrons and retained by the corporation in a revolving fund for capital

uses. In its ruling reversing the Tax Court's decision, the Court of Appeals pointed out that there was no statutory requirement, and no regulation or ruling in effect during the taxable years in question requiring notice by a nonexempt cooperative to the patron. Hence, the Court stated that it was not faced with the question of whether the Commissioner by regulation or ruling could validly impose a requirement that notice be given to the patron. It held that in the absence of such a requirement, there appeared to be no basis in law for a rule that notice must be given a patron of the dollar amount of his patronage refund as a prerequisite to the right of a nonexempt cooperative to exclude from gross income the amount of such refund. It is important to note that there is now in effect a regulation requiring such notice and, unless a nonexempt cooperative is prepared to challenge its validity, compliance with the regulation would seem necessary. (See Rev. Rul. 59-322, set forth in "Summary of Cooperative Cases", Legal Series No. 10, pp. 43-44, Sept. 1959.) Unless the Commissioner indicates acquiescence in this decision, even the invalidity of the retroactive portion of the regulation is not certain.

In opening its discussion on the broad issue, the Court pointed out that the validity of the Commissioner's assumption that patronage dividends, not having a reasonable ascertainable present market value, were taxable to the patrons had been upset by several courts of appeal. Long Poultry Farms v. Commissioner, 249 F. 2d 726; Commissioner v. Carpenter, 219 F.2d 635; Estate of Caswell v. Commissioner, 211 F. 2d 693. The Court then observed that on February 4, 1958, the Commissioner announced that he had acquiesced in the Carpenter and the Long Poultry decisions T.I.R. 69 (1958 CCH Par. 6350). See also 1958-1 Cum. Bull. 4. Subsequently, by T. D.'s 6428 and 6429, 1952-2 Cum. Bull. 26, 452, the Commissioner amended Section 1.61-5 of Treasury Regulations to conform to these decisions. The amended provisions provided that amounts allocated to a patron shall be included in the latter's income to the extent of cash received if the allocation is in cash, and to the extent of the fair market value of merchandise, capital stock or certificates received if the allocation takes such form. The Court asserted that the Commissioner had not attempted to amend his ruling holding such dividends to be an exclusion from the cooperative's gross income and that the first challenge to the broad right of cooperatives to exclude this type of dividend was made on appeal in this case and the Pomeroy case.

The Court's opinion continued:

"The broad attack upon the excludability of the patronage dividends involved in this case cannot be sustained. The Commissioner has for over forty years by his rulings and administrative practices

consistently authorized the exclusion or deduction from the cooperative's gross income of the patronage dividends, including those without a present market value to the patron. Congress, by the 1951 amendment authorizing patronage dividends of exempt cooperatives to be excluded in the same mammer as those of nonexempt cooperatives, at least impliedly approved the Commissioner's past treatment of patronage dividends of nonexempt cooperatives. Congress, as a result of the very extensive hearings, was fully aware of the treatment accorded patronage dividends and by its failure to enact proposed legislation to alter the situation acquiesced in the administrative interpretations. No effort has been made by the Commissioner to revoke or amend the rulings relied upon by the Tax Court, and such rulings apparently remain in full force and effect.

"We cannot say, upon this record, that the long standing and consistent policy of the Commissioner in considering noncash dividends as excludable from income of the cooperative is not a permissible interpretation of the provisions of the revenue statutes defining gross income.

"The primary responsibility for determining what should be included and excluded from income for tax purposes rests with Congress. If inequities result from the present method of taxing cooperative dividends, resort should be had to the legislative branch of the Government for appropriate relief.

"We reject the contention raised by the Commission on this broad issue."

With respect to its ruling on the narrow issue involving notice the Circuit Court noted that the Commissioner and the Tax Court had conceded that there was no express statute or regulation requiring that notice be given by a nonexempt cooperative to the individual patron advising him of the amount of his patronage refund. The Court did not accept the Tax Court's conclusion that since exempt ccoperatives were required to give such notice nonexempt cooperatives must also be required to do so. The Court asserted that it could not agree that the provisions of § 6044 I.R.C. 1954 requiring both exempt and nonexempt corporations to file information returns as to patronage dividends or regulations promulgated thereunder, made statutory provisions enacted solely with reference to exempt corporations, applicable to nonexempt corporations.

The Court's opinion continued:

"The fact is that Congress did place language in the statute governing exempt corporations, indicating that dividend allocations

for a taxable year could be made during a period of eight and one-half months following the close of the taxable year. Congress further provided by § 6072(d) that an exempt corporation is given until eight and one-half months after the close of a taxable year to file its income tax returns. No like provision is made for nonexempt corporations. Section 522 I.R.C. 1954 applies certain existing law as to the exclusion of dividends of nonexempt cooperatives to exempt cooperatives. We find nothing in the statute to indicate an intention to apply any of the provisions of the statutes applicable to exempt cooperatives to nonexempt cooperatives.

* * *

"There is considerable room for doubt whether in the absence of a statutory requirement, a regulation, even if one existed, could reasonably require the earlier reporting of the dollar amount of dividend to each patron of a nonexempt corporation. The reason for the applicable statute and regulation governing exempt corporations is likely that stated by the Tax Court to the effect that such provision would increase the likelihood of an early inclusion by the patron of his share of the patronage dividend credited to him on his own tax return.

* * *

"No cases have been called to our attention or found by us holding that giving notice to a patron of the dollar amount of his patronage dividend is a prerequisite to the right of a nonexempt cooperative to exclude or deduct from gross income the amount of such dividend.

"Likewise, there is no express statute making such requirement. We are not here faced with the question of whether the Commissioner by regulation or ruling could validly impose a requirement that notice be given to the patron, and do not decide such question. The taxpayer here has apparently met the traditional standards applied to this situation.

* * *

"We conclude that the Tax Court erred in denying taxpayer the dividend exclusions it claimed for the years 1953 and 1954."

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LABOR-MANAGEMENT RELATIONS - REFUSAL TO BARGAIN

(National Labor Relations Board v. Florida Citrus Canners Cooperative 288 F. 2d 630 (1961))

In proceedings for enforcement of an order of the National Labor Relations Board, the Fifth Circuit Court of Appeals found that the record did not support the conclusion of the Board that the cooperative had violated the National Labor Relations Act by wrongfully (1) refusing to bargain; (2) discharging striking employees; and (3) failing to get a formal decertification of the union. Since no basic issue of law was involved, the decision cannot be appealed. The effect of the decision is to cancel the Board's order which required, among other things, that the cooperative cease and desist from refusing to bargain and that it reinstate with back-pay the employees it dismissed.

On February 6, 1957, as the result of an election an AFL affiliate was displaced by the International Brotherhood of Teamsters, etc., Local No. 173, hereinafter referred to as the union, as the bargaining representative of the employees of the Florida Citrus Canners Cooperative.

A number of bargaining sessions were held from April to October, but no decision on a contract was reached. On December 18, the General Manager of the cooperative came to a meeting intending to ask for a delay in negotiations because of disasterous freezes which had occurred on December 12 and 13, greatly damaging the citrus crop. The union representative, Wingate, refused to listen to the manager and insisted on first stating his position. Wingate said the freezes were not a factor which would be considered in negotiations, and that the union's negotiating committee was authorized to call a strike whenever it saw fit. He gave the respondent until four o'clock of the same day to agree upon a contract or give assurances that a contract would be agreed upon. Confronted with the union's strike threat, the manager made no request for a delay in negotiations. The meeting broke up and the union made no effort to prolong it.

On Christmas Day, M. A. Stephenson, the cooperative's production manager, and J. E. Holly, then acting as a watchman, were at the plant. Holly quoted Stephenson as saying that a strike would be foolish; that the men would get along better if the union was "kicked out"; that the Company did not intend to sign a contract with the

union and there would be no more meetings with the union after February 6 when the union could be decertified. Holly quoted himself as saying he was disgusted with the talk of a strike and dissatisfied with the conduct of the negotiations by the union representatives. He quoted Stephenson as suggesting that Holly and other dissatisfied employees should attempt to form a group to begin decertification proceedings, and offering to procure legal counsel for such a group. Holly related that Stephenson told him that, in a few days, a pay raise would be posted on the bulletin board which would give the employees an incentive to get rid of the union. Stephenson's version of the conversation was vastly different. He denied, among other things, proposing that Holly initiate decertification proceedings and telling Holly that no contract would be made with the union. Stephenson's statement about a proposed pay raise, as he related it, made in response to Holly's inquiry was that the cooperative was considering making a proposal on wages to the union.

On January 4, 1958, cooperative submitted to the union a proposal for a pay raise of 5-1/2 cents per hour, which the union rejected. By letter of January 10, 1958, the union submitted a contract which was substantially the same as had been tendered with the deadline ultimatum made on behalf of the union on December 18, 1957, except as to the demand for a wage increase which was lowered from 25 cents per hour to 8-1/2 cents per hour. The letter stated twice that it was a "last and final" offer.

On or about January 16, 1958, the cooperative posted a letter to its employees, over the signature of Stephenson, advising them that the union had rejected the wage increase. A request was made for information as to threats and intimidation. A report on the effects of the freezes was made, and an offer was made to furnish information or answer questions concerning the general situation. On January 17, 1958, the union called a strike and a few more than one third of the employees went out, whereupon the cooperative replaced 274 of the striking employees and notified them that they were discharged. Ten of the discharged strikers were given notice to vacate company-owned dwellings which they were occupying, nine of whom were still in possession at the time of the hearing before the Examiner.

On January 28, 1958, another meeting was held at which time an unfortunate incident, precipitated by the union, occurred, which caused another impasse and this meeting broke up with no settlement of differences being attained. When the year had expired following the election which had resulted in the designation of the union as the bargaining representatives of the employees, petitions were

circulated by employees for the withdrawing of authorization for representation by the union. The solicitations for signatures on the petitions were made, in part at least, during working hours. The petitions were signed by 76.2 per cent of the employees. On February 20, the cooperative announced that the wage increase which had previously been offered would be put into effect. Thereupon the union requested a meeting, but the cooperative declined to meet unless the union was prepared to show that it then represented a majority.

On January 14, 1958, the union filed a charge against the cooperative based on its alleged refusal to bargain. A complaint was filed and a hearing was held. The Trial Examiner and the National Labor Relations Board then issued the order which this action sought to enforce.

After reviewing the foregoing facts the Court observed that to a considerable extent the findings of the Examiner and the Board were dependent for acceptance upon the testimony of Messrs. Wingate and Holly rather than the contradictory testimony of witnesses for the cooperative. The Examiner believed Holly and where sharp conflicts appeared on crucial facts, he believed Wingate. On such issues the Examiner disbelieved the witnesses for the cooperative.

The Court stated that it had found it necessary in prior instances to question the inferences drawn and findings made where the Examiner had uniformly credited the evidence for the General Counsel of the NLRB and generally disbelieved the evidence for the employer. The Court also stated that there was no evidence of anything transpiring prior to the Holly-Stephenson conversation that would have indicated anti-union animus on the part of the cooperative and that inferences drawn against the cooperative were supported by the assumption that its conduct was motivated by hostility to the union. The Court declined to accept the Examiner's findings as adopted by the Board in crediting Holly and discrediting Stephenson.

The Court found that the union, by its refusal to even consider a request for delay because of the freeze, was responsible for the impasse and termination of the ineffective meeting of December 18, 1957.

The Court stated that after negotiations were terminated on December 18, the cooperative was under a duty to resume bargaining only if so requested by the union. Since the union's letter of January 10 was not a request for the cooperative to bargain, the failure of the cooperative to reply to such letter was not a refusal to bargain nor evidence of such refusal.

The Court observed that although an existing certification was required to be honored until lawfully rescinded, an employer was justified in advising a union that it had lost its majority status during a lawful strike. The Court held that since the strikers had been replaced and discharged before requesting reinstatement, they were not entitled to reinstatement, and that the cooperative was not required to indulge in a useless gesture of petitioning for a decertification or engaging in further bargaining with the union. The Court also took the position that the granting of the pay raise was not an unfair labor practice as held by the Board.

# # #

ANTITRUST LAW - PRICE FIXING - INTERFERENCE WITH CONTRACT

(H. LeRoy Gammon v, Federated Milk Producers Association, Inc., (360 P. 2d 1018 (1961))

A section in the Utah State Constitution which prohibits "any combination . . . having for its object or effect the controlling of the price" of a product has been held by the Supreme Court of Utah to make "void" a marketing contract between an agricultural cooperative and its member.

A trucker, H. LeRoy Gammon, sued the Federated Milk Producers Association, Inc., a Utah agricultural cooperative for (1) treble damages for injuries compensable under the Utah antitrust laws, and (2) damages because of an alleged malicious interference by the cooperative with his hauling contracts with members of the cooperative. The cooperative asserted as a defense its prior exclusive marketing contract with the members. The lower court entered summary judgment for the cooperative on both causes of action. The Supreme Court sustained the summary judgment on the first cause, but reversed on the second cause, since it found the marketing contract "void" because it was in violation of the Constitution.

In 1951, Gammon entered into a written contract with a group of Utah County members of the cooperative to haul their milk. The cooperative knew of this agreement from its inception. The cooperative had at that time an agreement with its members whereby they appointed it their "exclusive agent for the purpose of selling all market milk produced" by them "for sale in the greater Salt Lake Metropolitian area", including "the authority to negotiate and fix all the terms and conditions surrounding the sale, delivery, and payment of said milk."

In 1955, many of the milk producers changed their method of handling milk from a milk can operation to a farm tank system which required the use of tank trucks in the delivery of the milk. Although Gammon offered to purchase tank trucks and demanded that his contract be honored, the cooperative obtained its own tank trucks and commenced hauling the milk of its members upon their conversion to the tank farm system. The conversion was quite general and Gammon was forced out of business.

Under his first cause of action, Gammon asserted that the cooperative's marketing contract, together with the assumption of milk hauling thereunder, "created a combination having for its object and effect the controlling of prices and the cost of transportation" in violation of the Utah constitution and antitrust laws. He failed, however, to allege that such practices caused him direct injury.

In upholding the lower court's dismissal of the first cause of action, the Court stated that even assuming that the cooperative fixed or controlled prices in violation of law, Gammon was not in a position to maintain action for damages as a result thereof, since the damage suffered by him was the loss of his milk haul which could not be attributed directly to the fixing or controlling by the cooperative of milk prices. The Court noted that under Gammon's theory of the case, the cooperative was controlling and fixing prices prior to Gammon's engagement to haul the milk, so obviously this conduct did not have any relationship to the loss of his haul.

Gammon also contended that the cooperative illegally monopolized a part of trade or commerce. The court said, however:

> "We find no support in the record that the defendant, in violation of our anti-trust laws, controls the transportation and marketing of milk in the State of Utah. The record indicates, and the lower court so found, that the members of defendant produce and defendant hauls to market approximately fifty percent of the Grade A milk produced in the Great Basin Marketing Area. However, absent any allegation or

proof that injury to the public resulted or that prices or quantities were controlled or fixed thereby, there is no constitutional or statutory interdiction against a person controlling a portion of trade or commerce."

On the second cause of action the lower court held that since the cooperative, in taking over the milk haulage, was acting pursuant to the terms of its contract with its members, it did not unlawfully interfere with Gammon's subsequent contract with such members. In reversing the summary judgment of the lower court for the cooperative on this cause, the Supreme Court held that upon the record it appeared that the cooperative, acting under the provisions of its agreement with its members, had engaged in fixing the minimum price for which milk was sold to distributors and processors. It declared that in doing so its conduct had come within the prohibitions of Article XII, Section 20, of the Utah Constitution prohibiting "the controlling of the price of any products of the soil, or of any article of manufacture or commerce, or the cost of exchange or transportation." The Court held that as a result thereof, the defendant's contract had to be regarded as void, and consequently could not be set up as a defense against the defendant's second cause of action.

The Court rejected the defendant's contention that the Uniform Agricultural Cooperative Association Act exempted it from the provisions of the above-mentioned section of the Constitution and the antitrust laws and asserted that some of the decisions of other jurisdictions indicated that such associations are not immune from the provisions of the antitrust laws if they do, in fact, engage in competition-shifting practices. The Court also cited the recent Supreme Court case, Maryland and Virginia Milk Producers Association, Inc. v. United States, 362 U.S. 458, which declared that the exemption afforded agricultural cooperative associations did not grant them unrestricted power to restrain trade or to achieve a monopoly.

The Court asserted that it was not necessary to determine whether the defendant had violated the antitrust statutes since it was confronted with the clear and unambiguous language of the Constitution prohibiting any combination having for its objective or effect the controlling of prices.

# # #

DISTRIBUTIONS BY NONEXEMPT PRODUCERS COOPERATIVE TO MEMBERS ON BASIS MAN-HOURS WORKED HELD NOT EXCLUDABLE AS PATRONAGE REFUND.

(Rev. Rul. 61-47, I.R.B. 1961-12, 8)

The following is the complete text of a recent ruling by the Internal Revenue Service, which is self-explanatory:

> Amounts distributed by a nonexempt cooperative association to its member-stockholders on the basis of man-hours worked by such stockholders for the cooperative association do not constitute true patronage dividends and, therefore, are not excludable from the gross income of the cooperative association for Federal income tax purposes. This is true even though a State law may provide that work performed as a member of a workers' cooperative shall be deemed to be patronage of the cooperative. The exclusion of true patronage dividends from the gross income of a cooperative association is based upon the fact that such patronage dividends represent either an additional consideration due the patron for goods sold through the association or a reduction in the purchase price of supplies or equipment purchased by the patron through the association. See Rev. Rul. 54-10, C.B. 1954-1, 24. Thus, the true patronage dividend is treated as a corrective and deferred price adjustment, which serves to reduce the amount of the cooperative association's gross profit from sales. See I.T. 3208, C.B. 1938-2, 127; and Rev. Rul. 57-59, C.B. 1957-1, 24.

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CONTRACTS - RETIREMENT - SUFFICIENCY OF CONSIDERATION

(Lowndes Cooperative Association v. R. L. Lipsey - Miss.- 126 So. 2d 276 (1961))

The above-cited case involves a question of the legal sufficiency of the consideration to support a retirement agreement. Appellee, R. L. Lipsey, broughtthis action in the Circuit Court of Lowndes County against Lowndes Cooperative Association, (hereinafter referred to as the "Cooperative") to recover the retirement payments allegedly due him from the defendant up to that time.

The jury found for plaintiff in the amount of $1,795. The lower court judgment was affirmed on this appeal.

The plaintiff who worked for the Cooperative for thirty-one years as its general manager suffered a stroke about three years prior to 1958, but recovered sufficiently to return to work. For several years the Cooperative had been operating at a deficit, and apparently there was some dissatisfaction among the members of the board of directors as to the management. The plaintiff, who also served as secretary of the board of directors, was not present at the board meeting of June 6, 1958, when it was decided he should be relieved of his duties as manager, as of June 30, 1958, and should be paid certain retirement payments. At a meeting on June 13, the board set up a retirement plan to be offered to the plaintiff which provided that he be relieved of duty on August 1, but continue to draw his salary of $265.00 for the next six months at the end of which time he would be paid $100 per month for twenty-four months. Under the terms of the plan he was free to do any work he pleased but he was asked to cooperate with the new management when necessary.

While the plaintiff reluctantly accepted the retirement offer, he did not attempt to encourage any active opposition among his friends who were members of the Cooperative, to the board's actions. Also, after the new manager assumed his duties on July 1, the plaintiff went to the place of business every morning for about an hour and a half and assisted in the indoctrination of the new management.

The Court rejected the Cooperative's contention that the retirement promises were mere gifts without consideration or constituted payment for past services which would be legally insufficient. The court held that acceptance by the plaintiff of the retirement promise without opposition and his cooperation with the new management constituted sufficient consideration to support the Cooperative's promise to make the retirement payments and to make it a binding obligation.

Although plaintiff had opened a small seed store, the Court said the jury was warranted in finding that this business was not in competition with the Cooperative's business, and, in any event, under the agreement plaintiff was free "to do any work as he pleases." Hence, the arrangement was not subject to any conditions subsequent.

# # #

MARKETING CONTRACTS - INDUCEMENT TO BREACH

(Carolina Milk Producers Association Cooperative, Inc. v. Melville Dairy, Inc.

(Superior Ct. N. Carolina, Greensboro Division)

In this case a judgment was entered enforcing marketing contracts of plaintiff, Carolina Milk Producers Association Cooperative, Inc. (hereinafter called the Cooperative) against a distributor, Melville Dairy, Inc. The court held that the distributor had induced 39 members of plaintiff to breach their contracts with the plaintiff and assessed a penalty of $500.00 for each. Judgment was also entered against the distributor for the full value of milk delivered less amounts previously paid the producers. A summary of the court's decision follows.

The plaintiff is a cooperative marketing association whose members are dairy farmers; the defendant is a milk distributor. Prior to September 1957, the association had notified the defendant of persons who were members of the association and who had executed milk marketing agreements or contracts with the association. These contracts were valid, subsisting and enforceable marketing contracts during the period from September 1957 through June 1958.

Prior to December 1957 the defendant had continuously recognized the validity of the aforesaid contracts. For several years prior to December 1957 the defendant regularly deducted each month from the proceeds of its milk purchases from the producer-members of the association the dues deductions of 6 cents per hundredweight of milk purchased which it remitted to the association.

Because plaintiff association undertook to have the defendant revoke and rescind a 10-cent per hundredweight increase in its hauling charge and brought the matter to the attention of the North Carolina Milk Commission, the defendant decided to embark upon a course of conduct designed to induce, or to attempt to induce, thirty-nine members of the plaintiff association to breach their contracts with the association.

On December 24, 1957, the defendant delivered to all producers from whom it purchased milk, including each of the aforesaid thirty-nine members of the association, a mimeographed letter inquiring as to whether or not the members desired it to discontinue deducting duesfor plaintiff, and if so, to sign a statement to that effect.

Beginning with the payments made on or about January 15, 1958, Melville Dairy stopped deducting and remitting to the association the 6 cents per hundredweight. At a meeting held April 14, 1958, attended by most of the association's members whose milk was being sold to the defendant, defendant's representatives advised them that the mimeographed or typed slips had been prepared for the signatures of those members who desired that payment for their milk be made directly to the association. Only three of the association's members signed the slips and one of them later repudiated his signing of the same. Thereafter, the defendant did remit to the association the total proceeds of the milk received by the defendant from the two members who did sign the slips hereinabove referred to.

Pursuant to its contract with its members, on March 31, 1958, the plaintiff made written demand upon the defendant to remit directly to it all the money which might thereafter become due to members of the association whose milk was being sold to the defendant, except such amounts as the defendant was required to deduct for the payment of assessments made by the North Carolina Milk Commission.

By its conduct, the defendant knowingly induced, or attempted to induce, thirty-nine members of the plaintiff association to breach their respective milk marketing contracts and agreements with the association and, therefore, the defendant is liable to the plaintiff in the penal sum of $500.00 for its inducing, or attempting to induce, each of said members to breach each of said contracts; and the plaintiff is entitled to have judgment against the defendant for the recovery of the penal sum of $19,500.

Under the terms of the marketing contracts, the plaintiff had the right to collect in its own name all the money owed by the defendant for the milk delivered by its members for the months of March, April, May and June 1958. Since the plaintiff received proceeds from only two members, it was entitled to recover $74,553.73, the amount payable for the milk delivered by the remaining thirty-seven producers. However, since the defendant had paid these amounts directly to the producers, the monetary recovery is limited to the amount of dues which the plaintiff would have been entitled to deduct from the proceeds of the milk payments if they had been remitted by the defendant.

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MILK MARKETING ORDER NO. 27 - REGULATION OF PRODUCER-HANDLERS - COMPENSATORY PAYMENTS OF NONPOOL HANDLERS - ULTIMATE DISPOSITION OF SKIM MILK

(Ideal Farms, Inc. and Franklin Lakes Dairy Producers, Inc. v. Secretary of Agriculture. 288 F. 2d 608 (1961))

(U. S. v. Lehigh Valley Cooperative Farmers, Inc. and Suncrest Farms, Inc.; Lehigh Valley Cooperative Farmers, Inc. v. Secretary of Agriculture; Suncrest Farms, Inc. v. Secretary of Agriculture.

(3 consolidated actions) 287 F. 2d 726 (1961))

(Newark Milk and Cream Co. v. Secretary of Agriculture 287 F. 2d 681 (1961))

Each of these cases involved the construction to be given certain sections of Federal Milk Marketing Order No. 27, regulating the handling of milk in the New York-New Jersey metropolitan area and issued pursuant to the Agricultural Marketing Agreement Act of 1937, as amended, 7 U.S.C. 601, et seq. The Newark Milk and Cream Company decision involved interpretation of the Order as it existed during the period of June 1954 to March 1955, when it only regulated the handling of milk in the New York milk marketing area.

The first case cited above shall be referred to as Ideal; the second as Lehigh and Suncrest; and the third as Newark.

In Ideal the issue involved the application of § 927.65 of Order 27 to milk which is produced by the handler as well as the milk the handler bought from others. In affirming the opinion of the District Court, 181 F. Supp. 62 (1960) (see "Summary of Cooperative Cases", Legal Series No. 14, Sept. 1960, p. 61) the U. S. Court of Appeals for the Third Circuit held that the Secretary of Agriculture did not exceed the authority vested in him by the Act in promulgating section 927.65 which purports to make a handler accountable to the producer-settlement fund for milk which he produces on his own farms from his own herds. In arriving at what the Court referred to as a "concededly broad construction" of the Act, numerous provisions of the statute were considered by the Court in the light of (1) the legislative goal, (2) the legislative history, (3) the long-established administrative interpretation, and (4) various prior decisions.

It was the contention of Ideal that the word "purchased" as it appeared in the Act (7 U.S.C.A. 608c(5)(A) and (C)) indicated that only milk "purchased" was subject to regulation and that it could not be construed to cover milk which they had obtained from their own farms.

The District Court had cited three cases as the basis for its conclusion that the regulation of "own-produced" milk by a handler is authorized by the Act, but Ideal argued that in none of these cases were the principals producers in the sense that they operated their own dairy farms and that in each case they acquired or received the milk subjected to assessment from another entity. Ideal said that although an agency cooperative was held to have "purchased" milk from its principals in two of the cases relied on by the District Court, two parties were involved, whereas in their situation only one party was involved and that no "purchase" was possible. The Circuit Court rejected this argument and stated that such reasoning would mean that Congress had intended to regulate a handler if he was the agent of a producer, but not a handler who was also a producer. The Court stated that in its opinion no such illogical distinction was contemplated and that if Ideal's construction of the word "purchase" were accepted the intent of the Act to achieve a fair division of the more profitable fluid milk market and a sharing of the burden of surplus milk among all producers would be avoided.

The Court also asserted that in its concededly broad construction given to the word "purchased" it was guided by the pronouncement of the Supreme Court in N.L.R.B. v. Lion Oil Co., 352 U.S. 282 (1956) that in expounding a statute, it should not "be guided by a single sentence or member of a sentence"; but should look "to the provisions of the whole law, and to its object and policy."

The Circuit Court observed that while it was true that handlers had been required to make payments into the producer-settlement fund only since 1953, it was also true from the very beginning that the Department of Agriculture had construed the Act so as to permit regulation of producer-handlers in their capacities as handlers.

A dissenting opinion was given by Justice Hastie.

In Lehigh and Suncrest the prime issue presented by the three appeals was whether certain provisions of Order No. 27 by requiring all non-pool handlers of milk to make a "compensatory payment" to the producers settlement fund for all non-pool fluid milk disposed of by them for Class I-A use in the marketing area contravened the provisions of the Agricultural Marketing Agreement Act of 1937,

as amended. In its opinion reported in 183 F. Supp. 80 (1960) the District Court invalidated the provisions of the Order for compensatory payments under the authority of the majority holding in Kass v. Brannan, 196 F. 2d 791 certiorari denied, 344 U.S. 891. (See "Summary of Cooperative Cases", Legal Series No. 14, Sept. 1960, p.61.

In reversing the judgment of the District Court, the Court of Appeals rejected the argument advanced by Lehigh and Suncrest that the mandatory compensatory payments imposed upon non-pool handlers for fluid milk distributed in the marketing area were inconsistent with the terms and conditions specified in section 8c (5)(A) and it concluded that this section "has no application to non-pool handlers". The express purpose of the Act, according to the Court's opinion, is to provide for "regional regulation" and the "establishment of the Act on a regional marketing basis necessitates differentiation between pool and non-pool handlers." Under milk marketing orders promulgated by the Secretary pursuant to the Act, the "pool handlers", said the Court, "are subject to full regulations" - i.e., they "must pay the uniform blend price to producers" and must account to the producer-settlement fund for their actual utilization of milk - whereas, the non-pool handlers "are not subject to full regulation, are not required to pay the uniform blend price to producers", and do not have to account to the producer-settlement fund for their actual utilization of the milk. Absent the compensatory payments, they are unfettered as to price, market and amount of distribution. Further, the Court of Appeals said that § 8c(5)(A) of the Act "makes no reference to equalizing either fully regulated or partially regulated handlers' costs. It provides solely for uniform minimum class prices for which the pool handlers must account to the producer-settlement fund. Nor does it take account of the initial cost of milk to handlers." In upholding the validity of the provisions for compensatory payments, the Court of Appeals said that it could not agree with Kass v. Brannan, in which compensatory payments were held invalid.

The two sections of Order 27 basically involved in Newark were §§ 927.31 and 927.44. The Newark Milk and Cream Company operated pool plants in New York during the period in controversy and also operated a non-pool plant at Newark, New Jersey. It received milk at its pool plant from producers and shipped it to its nonpool plant in Newark in the form of cream, milk, and skim milk. There it was processed, packaged, and distributed to its customers. The nonpool plant was not licensed to deliver milk in the marketing area. The records of the nonpool plant showed the receipt of 473,088 pounds of skim milk but did not disclose the ultimate disposition or utilization of large quantities of it. As a result

thereof the Market Administrator charged Newark Milk with the differential on the 473,088 pounds of skim milk pursuant to § 927.44 of Order 27. Section 927.44 provides in pertinent part:

> "For skim milk derived from Class II or Class III milk which skim milk enters the marketing area in the form of milk, fluid skim milk. . . or cultured milk drinks and there utilized or disposed of [in one of such forms], and for all other skim milk derived from Class II or Class III milk which is not established to have been otherwise utilized or disposed of, the handler shall pay a fluid skim differential . . . ." (Emphasis added.)

Section 927.31 provides in pertinent part:

> "In establishing the classification of milk received from producers, the burden rests upon the handler who received the milk from producers to show that the milk should not be classified as Class 1-A, and that the skim milk in Class II and Class III should not be subject to the fluid skim differential . . ."(Emphasis added.)

The Circuit Court rejected the contention of Newark that these sections of the order did not require it to establish the ultimate utilization or disposition of the skim milk in question outside the marketing area. The Court concluded that the Company did not satisfy that burden when it established that the skim milk was received at its nonpool plant in Newark and upheld the determination of the Market Administrator that the "fluid skim milk differential" was applicable in this case under these sections of the order.

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